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IN THE

Supreme Court of the United States

OCTOBER TERM, 1965

No. 574

PANHANDLE EASTERN PIPE LINE COMPANY, *Petitioner,*

v.

FEDERAL POWER COMMISSION, MICHIGAN PUBLIC SERVICE COMMISSION, COUNTY OF WAYNE, MICHIGAN, *Respondents.*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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September 15, 1965

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FEDERAL POWER COMMISSION, MICHIGAN PUBLIC SERVICE COMMISSION, COUNTY OF WAYNE, MICHIGAN, *Respondents.*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

Panhandle Eastern Pipe Line Company (Panhandle), Petitioner herein, respectfully prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the District of Columbia Circuit entered in the above entitled cause on June 22, 1965.

OPINIONS BELOW

The opinion of the Court of Appeals, dated June 22, 1965 (App. *infra,* p. 1a) is not yet reported. Opinions 269-B and 344-A of the Federal Power Commission (R. 150-171) are reported at 32 F.P.C. 634, and 32 F.P.C. 636, respectively; its order on rehearing (R. 182-8) is not yet reported.[1]

JURISDICTION

The judgment of the Court of Appeals was entered on June 22, 1965 (App. *infra,* p. 2a). The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

QUESTION PRESENTED

Whether a regulatory agency denies the fair and adequate hearing required by due process when, having raised alleged deficiencies in a company's proposal for the first time after the close of the administrative proceeding, the agency rejects the company's petition for leave to present additional evidence and be heard concerning such newly injected considerations and, nevertheless, uses the absence of such evidence as the basis for resolving a pending issue adversely to the company.

STATEMENT

Panhandle, a Delaware corporation, produces and purchases natural gas in the States of Texas, Oklahoma and Kansas, and owns and operates a natural gas pipeline system extending from Texas through

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[1] The prior opinions of the Court of Appeals in these proceedings are reported, *sub nom City of Detroit* v. *F.P.C.*, 230 F. 2d 810 (1955), *cert. denied,* 352 U.S. 829 (1956), and *Panhandle Eastern Pipe Line Co.* v. *F.P.C.*, 305 F. 2d 763 (1962), *cert. denied,* 372 U.S. 916 (1963). The Commission's prior opinions (Nos. 269, 269-A and 344) are reported at 13 F.P.C. 53, and 25 F.P.C. 784, 1214, 787 and 1215 respectively.

Oklahoma, Kansas, Missouri, Illinois, Indiana and Ohio to its northern termini in Michigan. The rates charged by Panhandle for the sale of natural gas for resale in interstate commerce are subject to regulation by the Federal Power Commission under the Natural Gas Act.

Panhandle's Hydrocarbon Operations

In addition to its jurisdictional activities of transporting and selling natural gas, Panhandle extracts from its gas stream, separates, processes, refines and sells, natural gasoline and other hydrocarbons. Part of these operations are conducted at Panhandle's extraction plant near Liberal, Kansas (R. 157). The remainder of such operations involved in this proceeding is conducted under a contract with Phillips Petroleum Company[2] under which Phillips extracts at its extraction plant at Sneed, Texas, natural gasoline and other hydrocarbons from Panhandle's gas stream, separates, processes, refines and sells the same and pays Panhandle a part of the total sales proceeds (R. 156-7).

All of Panhandle's profits from both of these operations were used by the Commission to reduce Panhandle's pipeline cost of service, thereby decreasing its gas revenues and rates. The result, of course, is that Panhandle and its stockholders who furnished the requisite capital were deprived of the net income from those separate hydrocarbon operations which are unrelated to Panhandle's jurisdictional activities.[3]

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[2] There is no affiliation between Phillips and Panhandle.

[3] During the test year in Docket G-2506, Panhandle received total revenues of $1,007,993 and incurred total operating costs of $587,114 with respect to the Liberal plant and realized $517,578 (gross plant revenues of $1,053,935 less allocated costs of $536,357) from the sale of hydrocarbons at Sneed (R. 80-81, 84, 157).

G-1116 Proceedings

In 1951, Panhandle filed with the Commission in Docket G-1116 new rates which became effective on February 20, 1952, subject to refund, as provided in Section 4(e) of the Act, 15 U.S.C. § 717c(e) (R. 124-5). Following hearings, the Commission, on April 15, 1954, issued its Opinion 269 (R. 122 *et seq.;* 13 F.P.C. 53), in which it concluded, *inter alia,*[4] that Panhandle's hydrocarbon operations at Liberal and Sneed constituted separate businesses and that neither the costs nor the revenues thereof should be credited against Panhandle's cost of service, i.e., reflected in the rates fixed for Panhandle's jurisdictional activities (R. 125-7; 13 F.P.C. at 77-8). The Commission, accordingly, undertook to make the requisite allocation of joint costs between extraction operations and regulated activities by a so-called Btu method (R. 128; 13 F.P.C. at 79).[5]

Upon review (*City of Detroit* v. *F.P.C.,* 230 F. 2d 810 (D.C. Cir., 1955), *cert. denied* 352 U.S. 829 (1956)),[6] the Court of Appeals, holding to be "unacceptable" the ground for the Commission decision, i.e. "the fluctuating and unregulated prices of natural gasoline and other liquid hydrocarbons" (230 F. 2d at pp. 820-1), set aside the Commission's order and re-

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[4] All the other issues initially involved in these proceedings have now been resolved.

[5] The Btu method reflects "the reduction in the volume of raw gas equal to the loss in heating value (Btu) due to the extraction of the liquid hydrocarbons plus the fuel used in the process" (R. 128; 13 F.P.C. at 79).

[6] Hereinafter referred to as the *City of Detroit* case.

manded the case "for further proceedings not inconsistent with this opinion" (*Id.* at p. 823).[7]

G-2506 Proceedings

In the meantime, in 1954, Panhandle filed with the Commission in Docket G-2506 new rates which, after suspension, became effective subject to refund (R. 109-10). The allocation method proposed by the Commission's Staff in this proceeding with regard to Liberal and Sneed,[8] was the same Btu method used by the Commission in Opinion 269 and virtually identical to that proposed in Panhandle's initial presentation. Compare R. 58, 68 with R. 69-72. In addition, after the decision in *City of Detroit,* Panhandle submitted uncontradicted evidence establishing that the extraction of light hydrocarbons, such as butanes and propanes,[9] had no effect whatever on the operation of Pan-

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[7] On the remand, the Commission, upon Panhandle's motion (see R. 51-2), provided in an order entered December 6, 1956, that (R. 57):

> "• • • the proceedings in Docket Nos. G-1116, *et al.*, should be reopened for the purpose of permitting the parties opportunity to present further evidence therein relevant and material to the issues and questions raised by the opinion of the court, and we shall hereafter so provide by further order."

Despite this assurance, the Commission did not reopen this proceeding to permit the introduction of further evidence.

[8] Since the hearings in Docket G-2506 were begun before the Court of Appeals handed down its decision in *City of Detroit,* this evidence was presented on the assumption that Panhandle's costs for the extraction operations were to be omitted from the pipeline cost of service.

[9] The gas stream as it comes out of the well typically contains various hydrocarbons such as methane (CH_4), ethane (C_2H_6), propane (C_3H_8), butane (C_4H_{10}), pentane (C_5H_{12}), etc. The weight of these hydrocarbons increases with the number of carbon (C) atoms. Natural gasoline consists predominantly of pentanes and heavier hydrocarbons.

handle's pipeline system (R. 13, 22, 24) and that the extraction of only 2.11 percent of the heavier hydrocarbons such as natural gasoline actually extracted at Sneed and of only 9.47 percent of the natural gasoline actually extracted at Liberal was helpful to improve the efficiency of Panhandle's pipeline operations (R. 13, 20, 23, 24).

Since all but a very small percentage of the total extraction (of both light and heavier hydrocarbons) at Liberal and Sneed as well as all of the separating, processing and refining operations at these plants were thus wholly superfluous to Panhandle's natural gas pipeline business, Panhandle claimed that the costs and revenues attributable to superfluous extraction should be treated separately and differently from those attributable to beneficial or incidental extraction. In so urging, Panhandle accepted the proposition that costs and revenues attributable to the *beneficial* or incidental extraction should be credited against the pipeline cost of service. However, it contended that there should be no such crediting with regard to the superfluous extraction, and that instead the costs of such extraction, including full compensation for loss of Btu value or other factors resulting therefrom, should, by appropriate allocation, be determined separately and excluded from the jurisdictional cost of service (R. 111; 25 F.P.C. at 789), thereby giving full credit in the natural gas rates for all costs applicable to such extraction.

In its Opinion 344, in which only three Commissioners joined (R. 109, 111-113; 25 F.P.C. 787, 797-8),[10]

[10] The Commission simultaneously issued Opinion 269-A in Docket G-1116, in which it undertook to apply the reasoning of Opinion 344 to the G-1116 proceeding (R. 133-8).

the Commission rejected Panhandle's position. Instead, the Commission held, on the basis of an alleged general rule purportedly set out in *City of Detroit,* that *all* of Panhandle's hydrocarbon profits must be used to reduce its pipeline cost of service (R. 111-2; 25 F.P.C. at 798).[11]

Upon review (*Panhandle Eastern Pipe Line Co.* v. *F.P.C.,* 305 F. 2d 763 (D.C. Cir., 1962), *cert. denied,* 372 U.S. 916 (1963)),[12] the Court of Appeals ruled that the Commission had erred in reading *City of Detroit* as requiring such crediting of all the hydrocarbon revenues where only a part of the extraction operations improved the efficiency of the pipeline system (305 F. 2d at 768). The Court, accordingly, remanded the case to the Commission "to reach an independent determination, in light of our opinion in the *City of Detroit* case, as to whether there should be an allocation of the extraction plant profits at Liberal and Sneed" (*Ibid.*).

Proceedings Subsequent to the Panhandle Remand

Since the Commission's brief filed with the Court of Appeals in the *Panhandle* case had for the first time claimed that Panhandle's evidence as to its proposed

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[11] On rehearing, one of the three participating Commissioners disagreed with the Commission's treatment of the Liberal and Sneed hydrocarbon revenues (R. 121, 140-1):

> "I had misgivings concerning the treatment of this issue at the time the opinion was rendered, but felt that the decision in the City of Detroit case did not permit any other result. On further consideration, I am so thoroughly convinced that the result we have reached is wrong that I would modify the opinion in this respect."

[12] Hereinafter referred to as the *Panhandle* case.

method of allocating costs between beneficial and superfluous extraction was deficient on certain allegedly critical aspects, Panhandle, on April 19, 1963—following the remand in the *Panhandle* case—filed with the Commission a "Petition for Opportunity to Present Evidence as to Extraction Issue Remanded by Court of Appeals" (R. 141-9), in which it requested the opportunity to present evidence with regard to these alleged deficiencies.[18]

Sixteen months passed, however, without any action by the Commission. Then, without reopening the record or receiving further evidence or briefs, the Commission on August 20, 1964, issued its Opinions 344-A and 269-B here involved in which it again ruled that all of Panhandle's revenues from the hydrocarbon operations at Liberal and Sneed should be credited against its pipeline cost of service. This time the Commission based its ruling on a finding that:

> "* * * Panhandle has failed to provide a method which would fairly allocate the extraction costs and revenues between pipeline and 'superfluous' extraction operations, and that the record does not provide any other basis for making any such allocation, or even for determining that such other allocation would have been appropriate. * * *" (R. 163).

In so finding, the Commission relied for the most part upon the alleged deficiencies in Panhandle's evidence which had been raised for the first time in the Commission's brief before the Court below in *Panhandle*—the very matters concerning which Panhandle had sought

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[18] Also, Panhandle offered to submit further evidence regarding the Liberal and Sneed extraction operations "to assist the Commission to arrive at a proper solution to this vexing problem" (R. 148).

and had been denied an opportunity to be heard. Thus, according to the Commission, Panhandle's proposed allocation method was deficient because, *inter alia,* it did not take into account "the cost to its jurisdictional rate payers of the loss of cheap expansibility of downstream pipeline facilities resulting from the utilization of such facilities for transporting gas for any 'non-jurisdictional' extraction at the two plants and for the loss in Btu or heating value of the gas stream as a result of the extraction operations." (R. 165).

In addition to pointing to the errors inherent in the Commission's decision, Panhandle's application for rehearing expressly requested again that Panhandle be allowed to submit evidence with regard to the considerations newly injected by the Commission, and specifically enumerated the areas in which it would submit such evidence (R. 171-81). However, on October 15, 1964, the Commission denied rehearing (R. 182-9).

Upon Panhandle's petition for review, the Court below affirmed (App., *infra,* p. 1a).

REASONS FOR GRANTING THE WRIT

In affirming the Commission's decision based upon newly-injected considerations as to which Panhandle had explicitly been denied an opportunity to present evidence or be heard, the Court below had decided an important question relating to due process of law in a manner which is contrary to other Court of Appeals decisions. Moreover, if not reversed, the decision below will provide strong impetus to the growing and totally unwarranted tendency—apparent from the several recent decisions cited *infra,* p. 10—among various of the regulatory agencies to flout the due process rights of parties in proceedings before them

under the guise of cleaning up their dockets and achieving expedition. Since "[t]he maintenance of proper standards on the part of administrative agencies in the performance of their quasijudicial functions is of the highest importance * * *" (*Morgan* v. *United States,* 304 U.S. 1, 22 (1938)), review by this Court of the decision below is, we submit, clearly called for.

1. The Decision Below Is Inconsistent With Other Court of Appeals Decisions

The affirmance by the Court below of the Commission's resolution of the hydrocarbon extraction issue against Panhandle on the basis of newly-injected considerations[14] and without according Panhandle an opportunity to present evidence and be heard thereon, plainly deprives Panhandle of the fair and adequate hearing which is an integral facet of due process. *Hill* v. *F.P.C.,* 335 F. 2d 355 (5th Cir., 1964); *American Louisiana Pipe Line Co.* v. *F.P.C.,* 344 F. 2d 525 (D.C. Cir., 1965); *Northeast Airlines, Inc.* v. *C.A.B.,* 345 F. 2d 484 (1st Cir., 1965); *Deep South Broadcasting Co.* v. *F.C.C.,* 347 F. 2d 459 (D.C. Cir. 1965).

In the *Hill* case, for example, which involved an F.P.C. dismissal of a producer rate filing for alleged failure to make out a *prima facie* case, the Fifth Circuit found that the two asserted deficiencies which, in

[14] Any possible doubt that these alleged deficiencies were not raised at any time during which evidence could be presented in these proceedings is dissipated by the Commission's express admission in its brief in the Court below in instant proceeding (at p. 19) that "the need to consider cheap expansibility as a factor in making a cost allocation involving the use of a pipeline's facilities for a non-jurisdictional extraction *had not been recognized by the Commission until after the hearings in this case*" (Emphasis supplied).

the Commission's view, had destroyed the producer's case stemmed from standards which "were not announced until [the entry of] the decision which simultaneously held that the proof was insufficient to make out the 'prima facie' case under them" (335 F. 2d at 358). Accordingly, the Fifth Circuit held that the Commission's reliance upon such newly-injected considerations "* * * deprived producers of a fair and adequate hearing because the standards to be applied were neither evolved nor announced until the decision holding them unsatisfied" (*Id.* at 362).

Since, also, here, Panhandle was unaware until long after the record was closed that the Commission intended to rely on these newly-injected considerations, the affirmance by the Court below of the Commission's reliance on these considerations in resolving the extraction issue against Panhandle without according Panhandle an opportunity to present evidence or be heard with regard thereto, patently is contrary to *Hill* and the other cases cited above.

2. The Decision Below Improperly Deprives Panhandle of Its Right to a Fair Hearing

That the affirmance by the Court below of the Commission's action herein is tainted by gross error, is clear not only from the *Hill* line of cases just discussed, but also from this Court's decision in *Morgan* v. *United States, supra.* In the latter case, Chief Justice Hughes speaking for the Court, expressly noted (304 U.S. at 18-19):

> "* * * The right to a hearing embraces not only the right to present evidence, but also a reasonable opportunity to know the claims of the opposing party and to meet them. The right to submit

> argument implies that opportunity; otherwise the right may be but a barren one. *Those who are brought into contest with the Government in a quasijudicial proceeding aimed at the control of their activities are entitled to be fairly advised of what the Government proposes and to be heard upon its proposals before it issues its final command.*" (Emphasis supplied).

Nor is the denial of due process mitigated in any way by the Commission's holding[15] that "if any allocation of extraction costs and revenues can be justified, it is the pipeline's responsibility to propose a proper segregation * * *" (R. 183). Such a holding flies in the teeth of the Commission's own accepted practice in such matters which had previously been followed in these proceedings. Thus, in situations involving allocation problems, it is commonplace, and indeed, usual practice, for the company to suggest one method; for the Commission's Staff to propose another method; for the Intervenors, if any, to suggest a third; and for the Commission either to adopt one of these methods or, on the basis of the record made, to develop and adopt still another method, which may or may not include elements of those proposed by the parties and/or the Commission's Staff. Inasmuch as a comparable procedure had been followed in the instant proceeding with regard to other issues involving allocation methods (see, e.g., R. 111-3), there had not been any prior indication that the burden of developing an appropriate allocation method with respect to the hydrocarbon extraction issue here involved lay exclusively upon Pan-

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[15] Since the Court below stated no grounds for its decision, we can only assume that it approved the holdings set out in the Commission's opinions in their entirety.

handle and that its failure to propose the precise method which the Commission later evolved and adopted would be penalized by the crediting of all the revenues of the superfluous operations against its pipeline cost of service.

Moreover, such a holding would, if accepted as valid, impose an unwarranted and impossible burden upon regulated companies. It has long been recognized that "allocation of costs is not a matter for the slide rule. It involves judgment on a myriad of facts. It has no claim to an exact science." *Colorado Interstate Gas Co.* v. *F.P.C.*, 324 U.S. 581, 590 (1945). Indeed, the imperfections inherent in most allocation methods led Mr. Justice Brandeis to comment that "it is much easier to reject formulas presented as being misleading than to find one apparently adequate." *Groesbeck* v. *Duluth S.S. & A. Ry. Co.*, 250 U.S. 607, 614-5 (1919). And because of the complexities of the problems usually encountered and the judgment elements involved in developing cost allocations, there typically may be more than one reasonable method. In such circumstances, there patently is no justification for the Commission to condition its willingness to allocate costs between beneficial and superfluous extraction (i.e., between jurisdictional and non-jurisdictional extraction) upon a requirement that the company propose an allocation method which not only is reasonable, but which is acceptable at all times to the Commission, however its membership may change.[16]

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[16] As noted *supra*, p. 5, in Opinion 269, the Commission had itself earlier applied the same method which Panhandle here proposed in allocating costs jointly incurred for natural gas and hydrocarbon extraction. See R. 128-9; 13 F.P.C. at 78-9.

3. The Commission Has No Jurisdiction Over Superfluous Hydrocarbon Extraction

The error of the Commission and the Court below is accentuated by the fact that all the hydrocarbon extraction over and above the very small percentage beneficial to pipeline operations clearly is not subject to Commission regulation under the Natural Gas Act. Although natural gasoline and light hydrocarbons are commingled as vapors with natural gas as it is produced at the wellhead, the Commission has long since recognized that "ethane and the hydrocarbons heavier than ethane" do not constitute "natural gas as defind in the Act" (*Panhandle Eastern Pipe Line Co.*, 12 F.P.C. 686, 706 (1953) and hence the sale of such ethanes and hydrocarbons is not a sale of natural gas within the meaning of the Natural Gas Act. See *Panhandle Eastern Pipe Line Co.*, 25 F.P.C. 787, 798, 854 (1961).

While the extraction of a very small percentage of the total natural gasoline extracted (but none of the lighter hydrocarbons)[17] is desirable to avoid condensation in Panhandle's pipeline system, the overwhelm-percentage of the total hydrocarbon volumes extracted is superfluous thereto. In fact, the uncontradicted evidence shows that such superfluous extraction is undertaken for the wholly separate and distinct business purpose of extracting, refining, processing and selling of hydrocarbons (R. 5-6, 48).

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[17] Of the three products extracted, namely, butane, propane and natural gasoline (R. 22), the record shows that " • • • from the standpoint of the transmission system, the extraction of butane and propane is entirely superfluous as under no circumstances would they condense in the transmission lines, it is only gasoline which is extracted in order to avoid condensation in the transmission lines" (*Ibid.*).

Consequently, the hydrocarbon extraction over and above that which is desirable to improve the efficiency of the pipeline and which is incidental to pipeline operations, is beyond the Commission's jurisdiction to regulate. Cf. *Phillips Petroleum Co.*, 24 F.P.C. 537, 562-5 (1960), *aff'd, sub nom., Wisconsin* v. *F.P.C.*, 303 F. 2d 380 (D.C. Cir., 1961), *aff'd,* 373 U.S. 294 (1963). Settled principles, accordingly, require that the costs allocable to the superfluous extraction be determined separately and the profits from such extraction not used to reduce the company's pipeline cost of service. See, e.g. *Colorado Interstate Gas Co.* v. *F.P.C., supra.*[18]

Also erroneous is the Commission's further ruling that its refusal to segregate the superfluous extraction costs was proper because "there is no basis in the record for assuming that any of the fixed costs of the extraction operations were *not* attributable to facilities necessary or beneficial for the pipeline's jurisdictional operation" (Emphasis in original) and that "there may have been variable extraction costs not assignable to pipeline operations" (R. 165).

Apart from the fact that these assertions are belied by the controlling facts of record, the separability *vel*

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[18] The purported "Commission's 'normal' method" which the Commission undertook to invoke (R. 167, see also, e.g., 160, 163) is inapplicable here inasmuch as it is based on decisions (e.g. *City of Cleveland* v. *Hope Natural Gas Co.*, 3 F.P.C. 150, 178-80 (1940), *rev'd* on other grounds, 134 F. 2d 287, 307-8 (4th Cir., 1943), *rev'd,* 320 U.S. 591 (1944); *Cities Service Gas Co.*, 3 F.P.C. 459, 480-2 (1943), *aff'd* 155 F. 2d 694, 703 (10th Cir., 1946), *cert. denied,* 329 U.S. 773 (1946)) in which it was assumed that *all* of the extraction was necessary, or at least beneficial, to the proper operation of the pipeline system, and no issue was raised or decided with reference to superfluous (i.e. neither necessary nor beneficial) extraction.

non of costs traceable to superfluous extraction is wholly irrelevant to the determination of the appropriate treatment thereof. Each of the Commission's several comments with regard to the lack of separability of such hydrocarbon extraction costs applies with equal force to the classic dual business situation common in the natural gas industry wherein sales are made both for direct consumption and for resale. Both situations are simply illustrations of a common practice wherein the same facilities are used jointly for the conduct of two separate businesses. It is well settled that the Commission is without authority to treat sales for direct consumption in the manner which the Commission has treated the superfluous extraction at Liberal and Sneed. See, e.g. *Colorado Interstate Gas Co., supra* at 593-4.

4. Panhandle Should Not Be Penalized for Commission Delays

Finally, contrary to the Commission (R. 163, 167-8), the fact that these proceedings had already been pending for a long time does not justify the Commission's failure to reopen. Administrative expedition is an unacceptable reason on its face; Panhandle's petition to reopen here denied by the Commission had been pending before the Commission for some sixteen months before the Commission took any action thereon. Moreover, one of the principal reasons for the prolonged delay prior to the filing of the petition to reopen had been the Commission's own failure to develop and apply an appropriate treatment of hydrocarbon extraction costs and revenues in keeping with the circumstances of this case. This failure of the Commission has itself twice (in addition to the instant proceeding) necessitated judicial correction which consumed considerable time.

Similarly, the fact that these proceedings now involve ratemaking for the past rather than the future (R. 163, 169), does not relieve the Commission of its duty to accord Panhandle the fair and adequate hearing which is an integral part of due process. The very magnitude of the amounts involved (aggregating more than $13,000,000) demonstrates the egregious error in the superficial approach and resulting invalid action of both the Commission and the Court below. Consequently, while undoubtedly " 'there must be an end to administrative proceedings' such as this" (R. 167-8), the desirability of such termination plainly does not and cannot override the right, guaranteed to Panhandle as a part of due process, to a fair and adequate hearing.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that this petition for a writ of certiorari should be granted.

Respectfully submitted,

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September 15, 1965

APPENDIX

APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 19016

PANHANDLE EASTERN PIPE LINE CO., *Petitioner*

v.

FEDERAL POWER COMMISSION, *Respondent*

COUNTY OF WAYNE, MICHIGAN
MICHIGAN PUBLIC SERVICE COMMISSION, *Intervenors*

On Petition to Review Orders of the
Federal Power Commission

Decided June 22, 1965

Before BAZELON, *Chief Judge*, and FAHY and WASHINGTON, *Circuit Judges*.

PER CURIAM: The prior history in this court of this case is found in *City of Detroit* v. *Federal Power Comm'n*, 97 U.S. App. D.C. 260, 230 F. 2d 810, *cert. denied*, 352 U.S. 829, and in *Panhandle Eastern Pipe Line Co.* v. *Federal Power Comm'n*, 113 U.S. App. D.C. 94, 305 F. 2d 763, *cert. denied*, 372 U.S. 916. The present petition is for review of orders of the Commission following our remand to the Commission by our judgment in the case last cited. We affirm the present orders as within the Commission's authority validly exercised as a result of the proceedings upon the remand.

Affirmed.

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

September Term, 1964

No. 19,016

PANHANDLE EASTERN PIPE LINE CO., *Petitioner,*

v.

FEDERAL POWER COMMISSION, *Respondent,*

COUNTY OF WAYNE, MICHIGAN and MICHIGAN PUBLIC SERVICE COMMISSION, *Intervenors.*

On Petition to Review Orders of the Federal Power Commission

Before: BAZELON, Chief Judge, and FAHY and WASHINGTON, Circuit Judges.

Judgment

This case came on to be heard on the record from the Federal Power Commission, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is ordered and adjudged by this court that the orders of the Federal Power Commission on review in this case are affirmed.

Per Curiam.

Dated June 22, 1965

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Cases:

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Cities Service Gas Company v. *Federal Power Commission*, 155 F. 2d 694, certiorari denied, 329 U.S. 773 — 3

Cleveland, City of v. *Hope Natural Gas Company*, 3 FPC 150 — 2

Columbus, City of v. *United Fuel Gas Company*, 5 FPC 279 — 2

Detroit, City of v. *Federal Power Commission*, 230 F. 2d 810, certiorari denied, 352 U.S. 829, rehearing denied, 352 U.S. 919 — 4, 5, 6, 7, 10

Hope Natural Gas Company v. *Federal Power Commission*, 134 F. 2d 287, reversed on other grounds, 320 U.S. 591 — 3

Interstate Commerce Commission v. *City of Jersey City*, 322 U.S. 503 — 10

Panhandle Eastern Pipe Line Company v. *Federal Power Commission*, 305 F. 2d 763, certiorari denied, 372 U.S. 916 — 5

Miscellaneous:

6 Moore's *Federal Practice* (2d ed.) — 10

790-244—65

In the Supreme Court of the United States

OCTOBER TERM, 1965

No. 574

PANHANDLE EASTERN PIPE LINE COMPANY, PETITIONER

v.

FEDERAL POWER COMMISSION, MICHIGAN PUBLIC SERVICE COMMISSION, COUNTY OF WAYNE, MICHIGAN

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL POWER COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. p. 1a) is reported at 348 F. 2d 340. Opinions 269–B and 344–A of the Federal Power Commission (R. 150–171) are reported at 32 F.P.C. 634 and 636. The Commission's Order Denying Rehearing and Granting Stay is reported at 32 F.P.C. 1123.

JURISDICTION

The judgment of the court of appeals was entered on June 22, 1965. The petition for a writ of certiorari was filed on September 15, 1965. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1) and

Section 19(b) of the Natural Gas Act, as amended, 15 U.S.C. 717r(b).

QUESTION PRESENTED

Whether, in the circumstances, the Commission erred in denying petitioner's request to reopen the administrative proceedings to take additional evidence on one of the issues involved in petitioner's rate cases.

STATEMENT

The court below affirmed two companion orders of the Federal Power Commission disposing of a single issue remaining in each of two proceedings involving successive filings of increased rates by Panhandle Eastern Pipe Line Company. The earlier filing (FPC Docket No. G–1116) was suspended for the statutory five-month period and, beginning February 20, 1952 (R. 150), those increased rates went into effect and were collected subject to refund until superseded (R. 54) by the other increased rates (FPC Docket No. G–2506). The latter, after five months' suspension, were collected subject to refund through August 31, 1958 (R. 155), when they in turn were superseded by increased rates not here at issue. As a result, although both proceedings, when initiated, involved prospective rates, only the matter of refunds has remained in question since 1958.

The underlying issue in dispute was first raised by Panhandle in the hearing on G–1116. Panhandle sought a departure from the Commission's normal [1]

[1] *City of Cleveland* v. *Hope Natural Gas Company*, 3 FPC 150, 178; *Cities Service Gas Company*, 3 FPC 459, 480–481; *City of Columbus* v. *United Fuel Gas Company*, 5 FPC 279, 290.

and judicially approved[2] treatment of the net revenues (after costs) derived from the extraction and sale of gasoline and other liquid hydrocarbons from its natural gas stream, *i.e.*, applying the net revenues as a credit against the cost of service used to fix the pipeline's rates. To justify a departure, Panhandle contended "that the extraction from its gas stream of natural gasoline and other liquid hydrocarbons" by plants at Sneed, Texas, and Liberal, Kansas,[3] "is a separate business voluntarily embarked upon for profit and, therefore, the net revenues derived from such business should not be credited to the cost of service" (R. 125).[4]

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[2] *Hope Natural Gas Company* v. *Federal Power Commission*, 134 F. 2d 287, 307–308 (C.A. 4), reversed on other grounds, 320 U.S. 591; *Cities Service Gas Company* v. *Federal Power Commission*, 155 F. 2d 694, 703 (C.A. 10), certiorari denied, 329 U.S. 773.

[3] The Sneed plant is owned and operated by Phillips Petroleum Company which there extracts the liquids and returns the residue gas to Panhandle, and pays Panhandle prevailing market prices for 58% of the extracted liquids. Panhandle itself owns and operates the Liberal, Kansas, plant and sells the extracted liquids at prevailing market prices. R. 126.

[4] Compare the somewhat altered wording of petitioner's contention since 1956 (see *e.g.*, Pet. 14–15) that "the overwhelming percentage of the total hydrocarbon volumes extracted is superfluous [to the avoidance of condensation in the pipeline, and] is undertaken for the wholly separate and distinct business purpose of extracting, refining, processing and selling of hydrocarbons (R. 5–6, 48). Consequently, the hydrocarbon extraction over and above that which is desirable to improve the efficiency of the pipeline and which is incidental to pipeline operations, is beyond the Commission's jurisdiction to regulate. * * * Settled principles, accordingly, require that the costs allocable to the superfluous extraction be determined separately and the profits from such extraction not used to reduce the company's pipeline cost of service. * * *"

In that proceeding the Commission first decided "to treat the gasoline operations of Panhandle as a separate business or department" on a basis not urged by Panhandle, *i.e.*, "that the rates which we prescribe for the sale of natural gas for resale should not rest in part upon the fluctuating and unregulated prices of natural gasoline and other liquid hydrocarbons" (R. 127; footnote omitted). However, the Commission's order was set aside on judicial review. *City of Detroit* v. *Federal Power Commission,* 230 F. 2d 810 (C.A.D.C., decided December 15, 1955), certiorari denied, 352 U.S. 829 (October 8, 1956), rehearing denied, 352 U.S. 919 (November 19, 1956). The court held (so far as pertinent here) that the possibility of such fluctuations was not a valid basis for refusing to credit the extraction revenues (230 F. 2d at pp. 820–821). It, accordingly, remanded the G–1116 case.

Meanwhile hearings were being held in G–2506 on the increased rates that had superseded those in G–1116, and Panhandle again sought to avoid the crediting of net revenues from the Sneed and Liberal extraction operations.[5] After the court of appeals' December 15, 1955, decision in *City of Detroit,* Panhandle introduced further evidence in the G–2506 record on the extraction issue, attempting to demonstrate that Panhandle incurred joint costs "for two businesses, that is

[5] Panhandle introduced evidence to the effect that some of the extraction, which "is not necessary * * * is desirable to improve the operating efficiency of the lines", but "most of the extraction at Liberal and at Sneed must be characterized as superfluous because the extraction operations * * * are carried far beyond the point required to insure that liquid will not form in the transmission lines" (R. 13).

the natural gas business and the hydrocarbon extraction business" and that on an annual volumetric basis only a small portion of the Sneed and Liberal extraction benefited the pipeline operation (R. 5). Before that hearing was closed, the examiner gave Panhandle further opportunity to present any additional evidence it might deem necessary in light of the denial of certiorari and of rehearing in *City of Detroit* in October and November 1956 (R. 55, 167).

In April 1961 the Commission issued opinions in both G–2506 (R. 109–121) and the remanded G–1116 (R. 133–138). It concluded that the net revenues (after cost) from all of the Liberal and Sneed extraction operations should be credited against Panhandle's cost of service (R. 111–112):

> We agree with the presiding examiner that the evidence presented by Panhandle is not sufficient to overcome the court's holding that where the extraction of hydrocarbons improves the efficiency of and is incidental to the operation of Panhandle's transmission system, the revenues derived from such extractions should be credited to its cost of service. Panhandle's additional evidence confirms our earlier finding that the extraction operations do improve the efficiency of the pipeline and therefore clearly come within the rule laid down by the court. * * *

On review (*Panhandle Eastern Pipe Line Co.* v. *Federal Power Commission*, 305 F. 2d 763 (C.A.D.C.), certiorari denied, 372 U.S. 916) Panhandle argued that the Commission should not, in the circumstances, credit all of the net revenues from the Liberal and

Sneed extraction operation, but only that portion of the extraction business which improves the pipeline's efficiency (305 F. 2d at 767).[6] The court, concluding that Panhandle had furnished no persuasive support for its position, held that the Commission was not compelled to make an allocation (citing the cases in which the Commission, with judicial approval, had credited all of the net extraction revenues). It held, however, that the *City of Detroit* decision did not, on the other hand, compel the crediting of all net revenues whenever some of the extraction improved the efficiency of the pipeline. Accordingly, it left the "question of allocation as a matter within the Commission's reasonable discretion" (305 F. 2d at 768). It then expressed its "serious doubt in this case as to whether the Commission so understood the City of Detroit decision," stating (*ibid.*):

> * * * Indeed, there are strong indications that the Commission believed that City of Detroit requires, where extraction operations in some way improve the efficiency of a transmission system, that the entire extraction revenues be credited to the pipeline. [Footnote omitted.]

Accordingly, the court remanded both G–1116 and G–2506 to the Commission "to reach an independent determination, in light of our opinion in the City of

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[6] The court there said: "* * * Panhandle seems to claim (1) that extraction operations which improve pipeline efficiency must be treated as within the Commission's jurisdiction, while those that do not should be treated as non-jurisdictional, and (2) that when jurisdictional and non-jurisdictional operations use the same facilities, the operating cost of these facilities should be allocated between them. * * *

Detroit case, as to whether there should be an allocation of the extraction plant profits at Sneed and Liberal" (*ibid.*)

Following this remand, the Commission ruled that Panhandle had not only failed to provide a fair method of allocation of extraction costs and revenues between its pipeline and its claimed "separate" or "superfluous" extraction business, but had failed to show any basis "for determining that such other allocation would have been appropriate." R. 162–163.

The Commission's analysis of the evidence (R. 156–167, 183–185) showed that at 32° Fahrenheit, the lowest pipeline temperature experienced, the condensation of gasoline and other heavy hydrocarbons out of the natural gas in the line under a pressure of 600 pounds would make it beneficial to the operation of the line to maintain extraction operations at a rate that might well approximate 100 percent of the Sneed and Liberal plants' total capacity (R. 164). Not only had Panhandle thus failed to show that less than the entire capacity of the plants was beneficial to pipeline operation; in addition, there was no proof of variable extraction plant costs in any significant amount, and no basis for assuming that the operation of the plants for purposes not beneficial to the pipeline would increase operating costs substantially above what they would be if the plants were operated solely to benefit the pipeline (R. 165).[7]

[7] To Panhandle's contention that its stockholders "would have been required to bear the loss if the [gasoline] price had been so low that the revenues were less than the cost of carrying out the operation", the Commission answered (R. 166–167):

> * * * Panhandle's stockholders would have the risk of loss only if we agreed with its theory that the major

The Commission's orders also denied Panhandle's petition (R. 141–149), filed following the remand, for an opportunity to present additional evidence on the extraction issue, because there was "no clear indication that the evidence offered * * * would likely lead to a different result" (R. 168):

> The petition fails to specify what kind of evidence would be offered and fails to allege what Panhandle would show. Panhandle does not show how it plans to meet the requirements of the court's two opinions in its attempt to justify utilization of an allocation of extraction costs and revenues. * * *

Accordingly, the Commission ordered refund of the excesses collected between February 20, 1952, and August 31, 1958 (R. 185–186).

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portion of costs and revenues should be attributed to the excess liquids as a "separate business". Especially since its own witness admitted that the extraction operations should be carried on "even though you had to throw the [extracted] material away", and that the extraction costs "would have been a proper component of the cost of service" even "if the price of gasoline had been low", we cannot agree that the responsibility for these costs should be borne by the stockholders.

To agree with Panhandle would leave the stockholders responsible for the cost of maintaining essential pipeline operations, an obviously erroneous result. Since it is recognized that the necessary extraction should be undertaken even at a loss the pipeline phase of the business should be treated as responsible for the costs and corollary revenues attributable thereto. This would leave the stockholders with no risk of loss other than that involved in its normal opportunity to earn a regulated rate of return. [Footnote omitted.]

In its opinion denying rehearing, the Commission observed further (R. 185): "Panhandle's portrayal of its extraction operations as a 'business separate and distinct from the natural gas pipeline business' is not borne out by the facts."

On October 15, 1964, the Commission denied Panhandle's application for rehearing (which again sought a reopening) but granted stay of the refund requirement pending completion of court review (R. 182–186). In overruling that request the Commission observed (R. 183–184):

> * * * As Panhandle admits, the Commission brief in the previous appeal from Opinion No. 344 listed a number of areas of deficiency in Panhandle's proof. Yet, in its 1963 petition to reopen the record, Panhandle contented itself with the general statement (at p. 10) that it "stands ready to supply additional factual information regarding these two plants and will, in any event, present evidence to assist the Commission in arriving at a proper solution to their vexing problem." Now, after the issuance of Opinions 269–B and 344–A, which set forth the areas in which Panhandle's showing was deficient, Panhandle still does not attempt to describe, even in general terms, the nature of any of the evidence it might be in a position to introduce.

Panhandle's petition for review was argued before the same judges who had sat in the preceding case (305 F. 2d 763). On June 22, 1965, that court affirmed the Commission's order by a *per curiam* opinion "as within the Commission's authority validly exercised as a result of the proceedings upon the remand" (Pet. App. pp. 1a, 2a).

ARGUMENT

Panhandle had two hearings on rate increases at which it presented evidence to support its contention

as to its revenues from extraction plants—*i.e.*, that extraction of gasoline and other liquid hydrocarbons at the Sneed and Liberal plants from the natural gas Panhandle transports in interstate commerce is an operation in large measure independent of its transportation operations and to that extent not to be taken into account in fixing its rates for natural gas. After the first Commission decision (which was in Panhandle's favor) had been judicially set aside (*supra*, p. 4) and the second (which denied an allocation) had been remanded for further consideration by the Commission (*supra*, pp. 5–7), Panhandle petitioned for another opportunity to produce evidence. However, as the Commission pointed out in refusing to reopen, the petition did not specify what kind of additional evidence Panhandle proposed to offer (*supra*, p. 8). And when Panhandle repeated the request in its application for rehearing, it "still [did] not attempt to describe, even in general terms, the nature of any of the evidence it may be in a position to introduce" (*supra*, p. 9). We submit that in the absence of a "clear indication that" petitioner proposed to introduce evidence that "would likely lead to a different result," the Commission plainly did not abuse its discretion. *City of Detroit* v. *Federal Power Commission*, *supra*, 230 F. 2d at 822; cf. *Interstate Commerce Commission* v. *City of Jersey City*, 322 U.S. 503, 514–519; 6 Moore's *Federal Practice* (2d ed.), pp. 3787–3790.

The Commission, upon a careful review of the evidence that was of record, found that "the pipeline phase of the business should be treated as responsible for the [extraction] costs and corollary revenues

attributable thereto", and "Panhandle's portrayal of its extraction operations as 'a business separate and distinct from the natural gas pipeline business' is not borne out by the facts" (*supra*, p. 8, n. 7). As its opinion discloses (R. 156–167), these findings were based principally on Panhandle's own evidence, and on testimony given by its principal engineering witness (see R. 13–50, particularly R. 45–46, 49–50). There is no claim that they are not adequately supported by the record. In view of this and Panhandle's failure to specify the nature of the supplementary proofs it would offer even after the deficiencies in its earlier request for a reopening had been pointed out (*supra*, p. 9), there is no warrant for its present attempt (Pet. 14–15) to reopen an essentially factual question before this Court.[8]

CONCLUSION

In sum, all that is now presented after protracted litigation is an attempt to question a refusal to reopen the record when the Commission, the trier of the facts, twice found that petitioner had given no adequate reason for reopening. Its ruling has been

[8] Nor is there basis for the suggestion (Pet. 10–13) that the Commission's decision was based on "newly-injected considerations" of which Panhandle did not have notice, and that Panhandle was therefore denied a fair hearing. From the beginning Panhandle has sought, in one way or another, to justify departure from the Commission's familiar method of treating extraction plant costs by attempting to show that it operates a separate business at Sneed and Liberal. The Commission's adherence to the established method rests simply upon its determination that Panhandle did not prove its point or show that further hearings might warrant a different conclusion.

reviewed and affirmed by the same court of appeals that had previously sent the case back to the Commission (supra, p. 9). Since the ruling turns entirely upon the particular facts of this case, there is neither conflict nor other reason for review by this Court. The petition should be denied.

Respectfully submitted.

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On Petition for Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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REPLY BRIEF FOR PETITIONER

The Commission's opposition to the grant of certiorari here is based on the claim that the instant case "turns entirely upon [its] particular facts" and hence "there is [no] conflict" (Br. in Opp., p. 12). Since this position turns upon the validity of the several assertions as to factual matters, we show below that

these assertions are wholly at war with the record and the true situation.

1. As shown in the Petition (p. 15, fn. 18), the Commission's assertion (Br. in Opp., pp. 2-3), that there is applicable here a normal and judicially approved method for the treatment of revenues from hydrocarbon extraction, is in error. The cases, in which hydrocarbon extraction revenues were credited against pipeline cost of service and on which the Commission here relies, have, in common, one extreme situation with regard to the relationship between such extraction and pipeline efficiency, namely, where it was found or assumed that *all* of such extraction was necessary or desirable for pipeline efficiency. On the other hand, in the other extreme situation, namely where *none* of the extraction affected pipeline efficiency, the Commission has pursued the opposite course and rejected the crediting approach. See, e.g., *Phillips Petroleum Co.*, 24 F.P.C. 537, 562-3, 679-83 (1960); *Panhandle Eastern Pipe Line Co.*, 25 F.P.C. 787, 798, 851-5 (1961). Since the uncontroverted facts in the instant case show that only a *very small portion* of the heavier hydrocarbons extracted during the year contribute to pipeline efficiency and the remaining overwhelming percentage is wholly superfluous thereto, none of the existing precedents are applicable here and the instant proceeding presents a case of first impression.

2. Also incorrect is the Commission's assertion (Br. in Opp., p. 7) that "Panhandle [had] failed to show that less than the entire capacity of the plants was

beneficial to pipeline operation." This is at odds with the very evidence of record cited by the Commission (R. 164) which plainly demonstrates that the maximum weekly[1] amount of desirable extraction at the Liberal plant during the coldest week of the year requires less than one-third of the total capacity of that plant.[2]

The Commission further asserts (Br. in Opp., p. 7) that Panhandle had failed to furnish "proof of variable extraction plant costs in any significant amount"[3] attributable to the superfluous extraction so that there is "no basis for assuming that the operation of the plants for purposes not beneficial to the pipeline would increase operating costs substantially above what they would be if the plants were operated solely to benefit the pipeline." Here, also, this assertion flies in the teeth of the uncontroverted and uncontrovertible fact that Panhandle's largest single item of costs with reference to the Sneed plant is the fee charged by Phillips (over $400,000 in the test year). Since this fee is a percentage of, and there-

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[1] The relevant period for determining the effect of changes in atmospheric temperatures upon the temperatures in the pipeline for condensation purposes is a week (R. 34).

[2] The maximum weekly beneficial extraction of 114,735 gallons (R. 164) is less than 30% of the average weekly extraction of about 385,556 gallons, computed by dividing the total annual volume of 20,048,918 gallons extracted at Liberal (*ibid.*) by 52 weeks.

[3] Variable costs are those which change in direct proportion to the volume of extraction, as opposed to fixed or capacity costs (such as depreciation) which do not vary with the level of plant operation.

fore necessarily directly proportional to, the gross plant revenues (R. 21, 157), the record plainly shows on its face that such cost bears a direct relationship to, and so varies directly with, the amount of hydrocarbon extraction.

Thus, there is simply no justification or warrant for the Commission's conclusory contention (Br. in Opp., p. 11) that its "findings were based principally on Panhandle's own evidence, and on testimony given by its principal engineering witness * * * there is no claim that they are not adequately supported by the record."

3. Likewise, contrary to the Commission's contention (Br. in Opp., p. 11, fn. 8), its decision herein *was* based on newly injected considerations of which Panhandle did not have notice. The Commission's contrary argument improperly fails to distinguish between the ultimate issue and the criteria for deciding that issue—two obviously separate and distinct matters. Although the ultimate question as to the proper treatment of the extraction costs and revenues had been in this proceeding from the outset, Panhandle was not aware until after the close of the record herein that the Commission intended to base its decision thereon upon considerations which were raised for the first time in the Commission's brief before the Court of Appeals in the *Panhandle* case.

The distinction between the ultimate question and the criteria for deciding that question is highlighted by the *Hill* group of cases, upon which the Petition (pp. 10-11) expressly relies and which the Commis-

sion's Brief in Opposition carefully avoids even mentioning. In these cases, also, the ultimate question had been known from the outset, yet the courts held that there had been a denial of fair hearing because the Commission had undertaken to decide the ultimate question on the basis of newly injected criteria as to which the company had not been given an opportunity to present evidence.

4. Finally, contrary to the Commission (Br. in Opp., p. 12), Panhandle did specify, to the extent, possible the nature of the evidence it would offer at the reopened hearing. Panhandle's petition to reopen not only expressly adverted to the considerations raised for the first time in the Commission's brief in the *Panhandle* case (R. 148), but stated (*ibid.*):

> "'Under the circumstances, it can hardly be disputed by the Commission that additional evidence would be necessary in order to evaluate the various methods whereby the costs of the Sneed and Liberal extraction operations could be fairly allocated. Panhandle, of course, stands ready to supply additional factual information regarding these two plants, and will, in any event, present evidence to assist the Commission in arriving at a proper solution to this vexing problem.'"

In the same vein, Panhandle's application for rehearing referred to its earlier offer "to present evidence relating to the matters * * * which had been raised for the first time by the Commission in its brief" in the *Panhandle* case, and specifically reiterated "its willingness to present such additional evidence at the reopened hearing if the instant application for rehearing is granted" (R. 179).

These offers fully assured the Commission that Panhandle would produce the evidence appropriate to the standards which the Commission had the burden to define. The Commission's action in basing its decision on newly injected considerations, while at the same time refusing to define the applicable standards, is clearly inconsistent with the *Hill* line of cases.

For the foregoing reasons as well as those set out in the Petition, it is respectfully submitted that this petition for a writ of certiorari should be granted.

Respectfully submitted,

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